

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)

Interconnection Between Local Exchange Carriers)
and Commercial Mobile Radio Service Providers)

CC Docket No. 95-185

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REPLY COMMENTS OF U S WEST, INC.

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- A “Cost-Recovery and CMRS Interconnection,” by Professor Robert G. Harris,
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U S WEST REPLY COMMENTS

U S WEST, Inc. owns numerous subsidiaries and partnership interests which provide a wide array of telecommunications, entertainment, and information services using both landline and wireless technologies. Among other things, U S WEST owns a large incumbent LEC, cable TV systems which will soon be providing telecommunications services in competition with other incumbent LECs, and CMRS providers, both existing and new.

U S WEST submits these reply comments, not on behalf of any one of its subsidiaries, but on behalf of itself, a holding company of many diverse firms and interests. U S WEST decided that it would not be helpful to the Commission for its telecommunications subsidiaries to file their own pleadings, because each would likely take a predictable position — one consistent solely with its own self interest. A proceeding as important as this requires a more global perspective that U S WEST, Inc. is uniquely situated to provide.

I. Introduction and Summary

There are two points the Commission needs to understand in addressing LEC-CMRS interconnection. First, the rapid convergence of the telecommunications industry requires the development of a rational and coherent interconnection and access policy for all users of the public switched telecommunications network. Establishing yet another patchwork interconnection policy for one industry segment, based upon the outmoded assumption that there still exist discrete industry segments, would constitute a step backwards, not a step forward.

Second, existing LEC-CMRS interconnection charges, while admittedly not perfect, are not a deterrent to the development of the CMRS industry — as evidenced by its phenomenal growth and the large sums entities are paying simply to enter the CMRS market. Rather, the real barriers to competition in the local loop are the prices paid for local residential service. Current residential rates are generally priced below cost, and it is obviously difficult for other carriers to provide a competing service when the incumbent LEC's prices are below cost. This problem is compounded by the fact that incumbent LECs have little flexibility to increase rates for local service and by the fact that incumbent LECs will be incurring additional costs in implementing the new Telecommunications Act — costs which will exacerbate the existing problem. Competition in the local loop will never flourish until the critical issue of local rates is addressed.

Consequently, to the extent the Commission wants to facilitate competition in the local loop, it should examine local rate issues as well as interconnection charges. Fixing

local rates will also fix many of the problems with interconnection and access charges (because those charges can be reduced once the revenues are no longer needed to subsidize below-cost local rates).

II. Rates for Local Residential Service, Not LEC Interconnection Charges, Are the Major Problem Inhibiting Competition in the Local Loop

The Commission commenced this proceeding because of a “concern” that its existing LEC-CMRS interconnection policies “may not do enough to encourage the development of CMRS, especially in competition with LEC-provided wireline service.”¹ Many CMRS providers have filed comments asserting that this concern is legitimate, although none documents its position with any facts.² What is more, none of these commenters addresses, or even mentions, the CMRS industry findings the Commission presented to Congress only months ago.³

The Commission is correct that the CMRS industry has not competed with LEC-provided landline service; indeed, it advised Congress recently that it is only “conjecture” whether “wireless services can eventually compete with wireline telephone service.”⁴

¹ Notice at 3 ¶ 2.

² CTIA, in an ex parte, did assert that a CMRS provider would pay a LEC \$36 monthly in interconnection charges just to serve a typical landline consumer. U S WEST documented in response that CTIA had its facts wrong because, at least using U S WEST’s LEC’s interconnection charges, a CMRS provider would pay less than \$2 to terminate the calls of a typical landline customer. See U S WEST Comments at 15-16. U S WEST finds it significant that CTIA chose not to repeat its baseless assertion in its comments.

³ See Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, First Report, 10 FCC Rcd 8844 (Aug. 18, 1995) (“First CMRS Report to Congress”).

⁴ First CMRS Report to Congress, 10 FCC Rcd at 8869 ¶ 75. See also Sprint Comments at 9 (“It is by no means clear that PCS could ever serve as a complete substitute for, or be considered a direct competitor of, wireline local service.”).

The reason for this, the Commission explained, was not due to LEC-CMRS interconnection charges, but to the fact that CMRS providers charge too much for their services and LECs have charged too little for their local residential services:

It therefore appears that wireless telephone service prices will have to fall well over fifty percent (or that wireline prices will have to rise to meet them) for wireless service to be fully price-competitive with traditional wireline telephone service.⁵

The Commission has taken steps to address the first problem: CMRS retail rates. By quadrupling the amount of spectrum allocated to CMRS service and tripling the number of licensees in each geographic area, the broadband CMRS market will become much more competitive. This added competition should lower prices for CMRS services and, in the process, encourage CMRS providers to expand their potential customer bases.⁶

However, the second problem — rates for local residential service — remains unaddressed. Even the CMRS industry acknowledges that local residential service is generally “priced below cost.”⁷ The local residential market will never become competitive so long as existing local residential services remain priced below cost and so long as incumbent LECs face such difficulty in raising these rates. In fact, absent meaningful reform in the near future, the local rate subsidy problem will only worsen — as LECs will

⁵ First CMRS Report to Congress, at 8869-70 ¶ 75.

⁶ The Commission staff has noted that at least in the past, “[t]he demand for mobile telecommunications [was] so great . . . that the two cellular carriers [did] not need to look to landline substitution as part of their market.” Michael J. Marcus and Thomas C. Spavins, The Impact of Technical Change on the Structure of the Local Exchange and the Pricing of Exchange Access: An Interim Assessment, at 22 n.41 (1993).

⁷ AT&T Comments, Docket 94-54, at 10 (June 14, 1995). See also CTIA Comments at 14-15 (“[T]he price for local service is kept artificially low.”).

face new costs (*e.g.*, investments necessary to provide mandated interconnection and unbundling) with minimal prospect of increasing local rates to recover these new costs.

This is a subject which must be addressed because it impacts the entire telecommunications industry. So long as local residential services remain priced below cost, other services like access and local interconnection must be priced above cost to provide the subsidy to local residential services.⁸ Meaningful reform in CMRS interconnection charges and interexchange carrier access charges will therefore occur only after the local rate subsidy issue is addressed.

Importantly, Congress has now given the Commission a powerful weapon to address this problem. Sections 253(a) and (d) of the new Act authorize this Commission to preempt any state action that has “the effect of prohibiting the ability of any entity to provide any . . . intrastate telecommunications service.” If the Commission is truly interested in facilitating competition in the local loop, it should commence a proceeding to determine whether it would be appropriate to enter a preemption order requiring that rates for local service exceed the cost of providing that service.

One thing is clear: under no circumstance can it be said that LEC-CMRS interconnection charges are the reason CMRS providers have not chosen to compete in the local loop. As U S WEST documented in its comments, the interconnection charges im-

⁸ As CTIA has stated, continuing subsidized local service “leaves wireless firms at a disadvantage in seeking to compete for local exchange business.” CTIA Comments at 15.

posed by its LEC would consume less than 3% of a CMRS provider's total revenues if it chose to offer a competing service to local residential service.⁹

III. "Bill and Keep" Is Not the Solution in Any Event

Even if existing negotiated LEC-CMRS interconnection charges were stifling the CMRS market, "bill and keep" would not be the solution to the problem. U S WEST demonstrated in its comments that "bill and keep" violates the most basic principle of economics: "The central tenet of economics is that prices play a critically important role in the allocation and distribution of goods and services in a market economy."¹⁰ CTIA, the most vigorous advocate for "bill and keep," now concedes that "bill and keep" violates this fundamental economic principle:

Price signals are important because the quantity of a service demanded by consumers is strongly influenced by the price of the service. The demand for a service effectively determines the resources devoted to provision of a service and the amount of the service made available at any given time.¹¹

Moreover, CTIA's economists further acknowledge that "bill and keep" not only "does not send optimally efficient pricing signals" for interconnected traffic, but it also "departs

⁹ U S WEST Comments at 16.

¹⁰ U S WEST Comments at 37, *quoting* U S WEST Attachment A at 4, A Response to Dr. Gerald Brock by Professor Robert G. Harris, Walter A. Hass School of Business, University of California, Berkeley.

¹¹ CTIA Comments at 25.

further from the optimal [price] signal than does” the existing rate structure which consists of a uniform, per-minute price.¹²

The failure of “bill and keep” to send proper price signals can do considerable damage to the telecommunications industry — and to consumers. For example, with the “bill and keep” advocated by the CMRS industry, CMRS providers would no longer have the incentive to use direct trunks to LEC end offices; it would be in their financial interest to deliver all traffic to a LEC tandem over one efficient trunk group, with the LEC responsible for transporting the call to the correct end office.¹³ U S WEST’s early experience with local competition is not encouraging: traffic at some of its local tandems has swelled, resulting in blocked call attempts.¹⁴

Moreover, there is no way for the Commission to limit “bill and keep” arrangements to CMRS service. Two large interexchange carriers have freely admitted that, if

¹² Steven R. Brenner and Bridger M. Mitchell, Economic Issues in the Choice of Compensation Arrangements for Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, at 32 (March 4, 1996), *appended to* CTIA’s Comments. Similarly, the economist retained by AT&T, another “bill and keep” proponent, acknowledges that “[b]asic principles of efficient pricing suggest that the correct long term solution to recovering these costs is for each network to charge the other carrier based on the costs of terminating traffic originating on the other provider’s network.” Declaration of Bruce M. Owen, at 4 ¶ 6, *appended to* AT&T’s Comments.

¹³ See, e.g., Sprint Comments at 10 (CMRS “provider[s] would find it more convenient to deliver traffic to a LEC at a single point of interface in a local calling area than to route it to multiple LEC end offices.”).

¹⁴ The sizable growth in tandem traffic is due to new entrants’ understandable preference to rely principally on tandem connections. The problem is that the tandem is now being used to switch traffic that U S WEST’s LEC once handled without the tandem, either because the call was an intraoffice call or was routed directly to the terminating end office. The blockage is impacting all network users and is occurring not only on U S WEST-AEC calls, but also on U S WEST-U S WEST calls. In addition, “bill and keep” arrangements do not provide U S WEST any source of investment dollars to finance the necessary network augmentation to relieve such blockage, virtually ensuring that U S WEST customers will have to subsidize the increased traffic by AEC customers.

the Commission adopts its proposal, IXC's "will seek to utilize bill and keep as a means of 'gaming' the system by opting out of the Commission's access charge regime completely."¹⁵ An IXC handling millions of minutes of interexchange traffic daily would have every incentive to terminate its traffic through a CMRS switch to take advantage of free termination (as opposed to paying access charges). This bypass of access (and/or local interconnection) charges will have severe financial ramifications for LECs, and it will exacerbate the tandem traffic blocking problem already being experienced.

Finally, with "bill and keep," the Commission must address the lost intrastate revenue stream issue. USTA documented in its comments that adoption of "bill and keep" for LEC-CMRS interconnections would negatively impact LEC intrastate rate bases by \$1.5 billion nationwide.¹⁶ The Fifth Amendment to the Constitution protects carriers, including LECs, from uncompensated government takings. Consequently, this

¹⁵ LDDS WorldCom Comments at 11. *See also* Sprint Comments at 13-14 ("The Commission should recognize that imposition of a bill and keep arrangement could raise the possibility that a long distance carrier would attempt to feed long distance traffic to a PCS provider in order to circumvent paying access charges to the LEC on the terminating end of the call.").

¹⁶ This \$1.5 billion figure includes \$1.1 billion in lost CMRS interconnection revenues and \$440 million in costs — costs which would still be incurred in a "bill and keep" arrangement. *See* USTA Attachment, Jeffrey H. Rohlf, Harry M. Shooshan, and Calvin S. Monson, Bill-and-Keep: A Bad Solution to a Non-Problem (March 4, 1996). The impact on individual LECs will vary. U S WEST documented that its LEC would lose almost 50¢ monthly per residential line. *See* U S WEST Comments at 49-53. Other incumbent LECs would face an even more severe problem. *See, e.g.,* Home Telephone Comments at 1 ("bill and keep" would result in loss of \$1.10 monthly per residential line"); Union Telephone Comments at 1; Illinois Telephone Association Comments at 2.

Commission may lawfully impose “bill and keep” only after it first finds an alternative revenue stream to replace the intrastate revenues lost through “bill and keep.”¹⁷

Remarkably, only one “bill and keep” proponent even addressed the important Fifth Amendment issue in its comments. Sprint/APC contend (in less than two pages) that “bill and keep” would not implicate the Fifth Amendment because the Commission is not proposing a permanent physical invasion of property and would not deprive LECs of economical or productive use of their property and because LECs would be able to recover all of the costs from other customers.¹⁸ Sprint/APC are wrong on all counts, as U S WEST explained in its comments.¹⁹

The Commission should expect constitutional courts to scrutinize Fifth Amendment taking claims from a different perspective now that competition has been injected into the local exchange market. Under monopoly conditions, the Fifth Amendment was generally satisfied if rates allowed a LEC to obtain overall revenues, from all regulated services, sufficient to recover costs and a fair return on investment. This meant that regulators could set the price of one monopoly service below cost so long as the prices of other monopoly services were sufficient to generate the required fair return. However,

¹⁷ However, even if new revenues were located, the fact that the Commission would be requiring U S WEST’s LEC and its other customers to subsidize its competitors by dedicating its property to its competitor’s use at non-compensatory rates would also be of highly dubious constitutional validity.

¹⁸ Sprint/APC Comments at 26-27. Even if Sprint/APC were correct that LECs would be able to recover their CMRS interconnection costs from non-CMRS customers, LECs would still be placed in the untenable position of having to get permission from their state commissions to raise rates in order to make up for a federal policy change.

¹⁹ See U S WEST Comments at 49-53.

now that competition is permitted in all LEC markets, requiring a LEC to provide any service — including local residential service — at a price below cost will constitute a taking.

IV. Mandatory “Bill and Keep” Would Appear to Contravene the Telecommunications Act of 1996

Congress, in enacting the Telecommunications Act of 1996, decided to establish a “new model” for local interconnection.²⁰ Under this new model, both the incumbent LEC and the carrier requesting interconnection are directed to negotiate “in good faith the particular terms and conditions” of their interconnection, with state commissions empowered to approve negotiated agreements and to arbitrate issues on which the two parties cannot agree.²¹

Congress further directed that this duty to negotiate includes “[t]he duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.”²² So important is mutual compensation among co-carriers that Congress specified that, in resolving interconnection disputes, state commissions may not impose interconnection terms unless they include a provision “for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier’s network facilities of calls that originate on the network facilities of the other car-

²⁰ Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 121 (1996).

²¹ Sections 251(c)(1), 252(b), and 252(e).

²² Section 251(c)(1), which incorporates Section 251(b)(5).

rier.”²³ Carriers are given the flexibility to “waive mutual recovery” of costs and use alternative arrangements like “bill-and-keep,” but only if they agree voluntarily to use these alternative arrangements.²⁴ However, nothing in the Act gives any regulator the ability to force carriers to use “bill and keep” when they do not so choose.

The new Sections 251/252 statutory regime, on its face, would appear to provide the exclusive method by which CMRS providers and incumbent LECs must compensate one another for the transport and termination of their traffic. As many commenters recognize, nothing in these provisions gives this Commission the authority to mandate that all LEC-CMRS interconnection agreements be on the basis of “bill and keep.”²⁵ In addition, while state regulators must honor voluntary decisions to “waive” the mutual recovery of costs, they, too, are not authorized to mandate “bill and keep” or other non-cost-based compensation arrangements in the absence of the agreement of both parties.

Certain CMRS providers now ask the Commission to ignore this “new model” for local interconnection, arguing that the new Section 251/252 procedure is not the exclusive procedure for local interconnection.²⁶ These CMRS providers assert that this Com-

²³ Section 252(d)(2)(A)(i).

²⁴ Section 252(d)(2)(B)(i).

²⁵ See, e.g., Comments of Alaska Telephone Association at 5; ALLTEL at 6-7; Ameritech at 11-13; Bell Atlantic at 3-6; Bell Atlantic/NYNEX Mobile at 7-8; BellSouth at 10-13; Cincinnati Bell at 7-8; GTE at 10; NTCA at 3-6; NYNEX at 10; Pacific Telesis at 1-4; and SBC Corporation at 8-9.

²⁶ The CMRS industry appears to have abandoned its early argument that CMRS providers are not “telecommunications carriers” under the new Act. See, e.g., Cox Enterprises Ex Parte Memorandum, Docket No. 95-185, at 5 (Feb. 28, 1996) (“CMRS providers generally fit the definition of ‘telecommunications carrier.’”). See also U S WEST Comments at 57 n.135.

mission is free to adopt interconnection policies which are incompatible with the new interconnection model (by mandating “bill and keep” rather than mutual recovery of costs). At bottom, these CMRS providers make the astonishing argument that, in adopting a comprehensive model for local interconnection, Congress simultaneously empowered the Commission to eviscerate the new model.

The argument of these CMRS providers is as follows:

1. Section 251(i) contains a general savings clause which acknowledges this Commission’s continuing authority under Section 201.
2. Section 201 empowers this Commission to order interconnection between carriers and to set rates for interstate traffic traversing the interconnected facility (*e.g.*, LEC access charges).
3. Section 201 must be read in conjunction with the 1993 amendment to Section 332(c) and, notwithstanding the unambiguous language in amended Section 332(c), notwithstanding the Commission’s repeated interpretation of that statute to the contrary, and notwithstanding that most interconnected traffic involves intrastate traffic, this Commission is nonetheless free to preempt entirely the subject of LEC-CMRS interconnection — including the rates LECs charge for interconnection.
4. With this new preemption power, the Commission is also free to adopt interconnection policies and arrangements which are inconsistent with the new Act.

There are many problems with this argument. One can imagine Congress’ surprise that, having just enacted a new model for local interconnection, this Commission interprets the statute as empowering it to ignore the new model and impose its own, different stamp on local interconnection arrangements.

The “bill and keep” proponents read too much into the Section 251(i) savings clause referencing the Commission’s authority under Section 201. That clause was added

to clarify that the Commission continues to maintain jurisdiction over interstate services (like access charges), while Sections 251 and 252 address local interconnection. Congress certainly did not add this clause as a way to eviscerate the new statutory scheme altogether.²⁷

Section 332(c) also does not authorize this Commission to preempt the rates LECs charge CMRS providers for interconnection. As the Commission has already held,²⁸ Section 332(c)(3) preempts state regulation of “the rates charged by” CMRS providers, not the rates charged to CMRS providers.²⁹ Besides, even if there were any ambiguity in Section 332(c)(3) over which regulator — state or federal — had primary jurisdiction over LEC-CMRS interconnection pricing, the fact remains that the Section 251/252 provisions would govern because “[i]f there is an irreconcilable conflict between the new

²⁷ See, e.g., Ohio Power v. FERC, 954 F.2d 779, 784 (D.C. Cir. 1992)(“[I]t is black letter law that when a conflict arises between specific and general provisions of the same legislation, the courts should give voice to Congress’s specific articulation of its policies and preferences.”). Besides, had Congress intended to exempt CMRS providers from the 251/252 regime, it could easily have done so by excluding them from the definition of telecommunications carriers (just as it did when it excluded them from the definition of local exchange carrier).

²⁸ In its comprehensive proceeding implementing the 1993 amendments to Section 332(c), this Commission held that “revised Section 332 does not extend the Commission’s jurisdiction to the regulation of local CMRS rates” and that it “will not preempt state regulation of LEC intrastate interconnection rates applicable to cellular carriers” and paging companies. Implementation of Sections 3(n) and 332 of the Communications Act, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd 1411, 1480 at ¶ 179, 1498 at ¶ 231 (1994). Indeed, it was only last year that the Commission reaffirmed that state commissions had jurisdiction over LEC-CMRS interconnection pricing. See Louisiana CMRS Rate Order, 10 FCC Rcd 7898, 7908 (1995).

²⁹ A handful of CMRS providers argue that the Commission should preempt LEC interconnection rates because those charges impact the retail rates CMRS providers charge to their customers. However, this is true of all goods and services used by CMRS providers. If these providers were correct in their analysis, this Commission could also then preempt state regulation of electric and gas service rates because those rates also impact CMRS retail rates.

provision and the prior statutes, the new provision will control as the later expression of the legislature.”³⁰

Finally, there is no need for the Commission to turn to this tortured construction of the 1993 and 1996 statutes for assurance that state action concerning local interconnection will be consistent with Sections 251 and 252. While giving authority in the first instance to states to implement the local interconnection provisions in the 1996 Act, Congress also built in several safeguards.³¹ As a general matter, such state implementation must, of course, be consistent with the substantive standards in the Act and with this Commission’s regulatory framework. One specific statutory safeguard is the provision for review in federal court to determine whether a state commission act meets the requirements of Sections 251 and 252.³² A further safeguard is the Commission’s authority to preempt state regulations not consistent with the requirements of Section 251.³³

The industry has not yet had an opportunity to implement Congress’ new model for local interconnection. In these circumstances, it would be imprudent for this Commission to order some local carriers to use a different interconnection model. And it

³⁰ Norman J. Singer, 2B Sutherland Statutory Construction, 112 (1992). If Congress had intended for Section 332 to apply and not Section 252, it would have easily indicated in Section 252 that the section applied “except as provided in Section 332” — just as it did in Section 253 involving the removal of barriers to entry.

³¹ These safeguards now render irrelevant the handful of PUC decisions involving LEC-CMRS interconnection cited by the CMRS industry. To the extent these orders do not comply with the new Act or this Commission’s regulations implementing that Act, they will have to be modified accordingly.

³² See Section 252(e)(6).

³³ See Section 251(d)(3).

would certainly be imprudent for this Commission to adopt an interconnection compensation policy that is flatly inconsistent with the compensation policy adopted by Congress.

V. Interconnection Charges Must Be Based on More than Incremental Costs

A handful of commenters go beyond the “bill and keep” issue. They assert that, if the Commission rejects “bill and keep,” it should limit interconnection compensation levels to a LEC’s total service long run incremental costs (“TSLRIC”).³⁴ For the most part, these commenters limit their argument to repeating the Commission’s observation that LRIC is “the theoretical foundation for efficient pricing of interconnection and other network services.”³⁵

U S WEST agrees that long-run incremental cost should be used as the cost floor to protect against cross-subsidies to competitive services. However, no carrier should be required to limit its prices for network services (including interconnection) to its incremental costs because, as the Commission and the CMRS industry correctly note, setting the price of each discrete service based on the incremental cost of that service “will not

³⁴ See, e.g., AT&T Comments at 16-17; LDDS Comments at 7-10; MCI Comments at 8-10.

³⁵ Notice at 24 ¶ 47 (emphasis added).

recover the total costs of the network.”³⁶ It is precisely for this reason that, in the real world, most firms and industries do not limit their prices to incremental costs.³⁷

Common costs are an important factor in setting prices.³⁸ In many industries, and especially in network industries, there are substantial economies of scale and scope that significantly improve production.³⁹ Not all of these costs are included in the calculation of specific incremental costs — that is, the sum of the TSLRIC for all services is considerably less than the total of a carrier’s costs to provide telecommunications services in the most efficient manner (*i.e.*, by sharing infrastructure and resources across services). All firms, not simply regulated firms, either price to cover all of their costs — or they cease to exist. Hence, cost-based pricing does not mean limiting prices to incremental costs alone; efficient prices should include a markup above the incremental cost — at least if a company wants to stay in business.

Prices should also take account of the conditions of demand for a particular service — that is, prices should be market-based as well as cost-based.⁴⁰ Markup pricing is

³⁶ *Id.* at 24 ¶ 48. *See also* CTIA Comments at 35.

³⁷ *See* Attachment A, “Cost Recovery and CMRS Interconnection,” where Dr. Harris explains why competitive firms do not limit their prices to their incremental costs.

³⁸ Incumbent LECs are also entitled to recover their legacy costs that have accumulated as part of their regulatory compact. The subject of legacy costs is addressed in Attachment A, “Cost Recovery and CMRS Interconnection.”

³⁹ For example, the underlying infrastructure — such as conduit and poles, operating systems, and the technical and managerial human capital that is shared among many different services — is a source of scope economies in the provision of telecommunications services.

⁴⁰ *See* Attachment A, “Cost Recovery and CMRS Interconnection.” This principle applies that as demand conditions change over time due to competition, technological innovation, or changing customer preferences, the markups of prices over costs should also change. *Ibid.*

widely practiced in competitive markets because all firms must price to recover their shared and common costs. Consequently, in industries with common costs, competition does not drive prices to incremental costs.⁴¹

This point is demonstrated by LEC-CMRS interconnection. The CMRS industry readily acknowledges that it does not have a business without LEC interconnection.⁴² However, with LEC interconnection, not only does the CMRS industry have a business, but it has “a highly profitable business.”⁴³ Indeed, even though current interconnection charges include a markup to subsidize local service, the CMRS industry is nonetheless able to include “a significant premium” in the prices of its retail services and, as a result, is able to earn “economic rents of significant proportions.”⁴⁴

A LEC’s common costs are incurred on behalf of all network users — including its retail customers and its wholesale customers (like CMRS providers and other interconnectors). The CMRS industry has acknowledged that the failure to include common costs in the services used by a particular group of network users would result in that group being effectively subsidized by other network users:

⁴¹ Ibid.

⁴² *See, e.g.*, CTIA Comments at 31 (“CMRS providers can only attract customers if they can offer termination to wireline networks.”).

⁴³ First CMRS Report to Congress, 10 FCC Rcd at 8853 ¶ 28.

⁴⁴ Id. at 8869 ¶ 75 and 8871 ¶ 81

The Commission [has] permitted LECs to include overhead loading because without it, all other LEC services would be required to recover a greater share of overhead costs or the LECs would lose revenues.⁴⁵

However, in making its “LRIC-only” argument, the CMRS industry has yet to explain why it, among all network users, should be entitled to preferential treatment with other network users subsidizing its interconnection services. Like other network users, CMRS providers benefit from the efficiencies and economies resulting from common costs incurred by a LEC.

That a carrier may recover its common costs from all network users is universally recognized. Even AT&T, apparently a recent “LRIC-only” convert, recognized just months ago that “a decade of FCC decisions recognize that telecommunications services may be priced to exceed their marginal or incremental costs — and must in aggregate recover their fully distributed or average costs”:

The reality is that because fixed costs of telecommunications facilities are high and the marginal costs are very low, prices for telecommunications services must exceed marginal costs (and make a contribution to fixed costs) for carriers to remain financially viable.⁴⁶

And as acknowledged in a recent study prepared for the European Commission, “[i]nterconnection charges set at LRAIC would fail to provide contributions to the regulated

⁴⁵ CTIA Comments at 15 n.25.

⁴⁶ Joint Brief of Petitioners AT&T Corp. and the Competitive Telecommunications Association, No. 94-70197, at 27-28 (9th Cir., filed Aug. 17, 1995)(internal citations omitted).

firm's truly common costs and other justified revenue requirements. Therefore, mark-ups on this [LRAIC] cost standard should be allowed.”⁴⁷

U S WEST readily acknowledges that some limits must be imposed on the ability of LECs to recover common and legacy costs from interconnectors — to ensure that interconnectors do not pay a disproportionate share of those costs. U S WEST therefore recommends that incumbent LECs be limited to charging TSLRIC plus a proportional share of common/legacy costs that do not exceed the share of such costs a LEC charges its own retail customers. However, this standard can be implemented only after rates of local residential service have been increased to cover their costs (*e.g.*, TSLRIC plus a proportionate share of overhead loadings). In addition, under no circumstances should LECs be required to allocate on a proportional basis less of a margin (*e.g.*, common/legacy costs) to interconnectors compared to that allocated to their own retail customers.⁴⁸

⁴⁷ B. Mitchell, W. Neu, K. Neumann, and I. Vogelsang, “The Regulation of Pricing of Interconnection Services,” in Gerald W. Brock, editor, Toward a Competitive Telecommunications Industry: Selected Papers from the 1994 Telecommunications Policy Research Conference, at 113 (Lawrence Erlbaum Associates, 1994).

⁴⁸ Requiring incumbent LECs to interconnect with newer carriers is often justified under the essential facilities (or “bottleneck”) antitrust doctrine. However, these decisions provide no support whatever for the claim that incumbent LECs can be required to provide interconnection for free or at rates less than they charge their own retail customers. To the contrary, antitrust courts have made clear that the antitrust laws do “not forbid a monopolist to set profit-maximizing prices”:

[Setting high prices] is not the exclusionary conduct that violates the antitrust laws, but rather is “the normal rational response of a business . . . seeking to maximize profits, sales or revenues.” Trace X Chemical v. Canadian Industries, 738 F.2d 261, 268 (8th Cir. 1984).

As another antitrust court observed:

VI. The Commission Is Charged With Promoting the Public Interest, Not the Private Interests of One Industry Segment

Existing CMRS interconnection contracts were negotiated in good faith, filed with and often approved by state commissions, and have not been subject to complaint. Nevertheless, it is not surprising that many CMRS providers support the Commission's proposal to mandate free interconnection for LEC end office terminations. Everyone prefers getting something for nothing.

What is surprising is that the CMRS industry, oftentimes in the same pleading, takes such a conflicting view of the Commission's proposal. While many CMRS providers assert that the Commission's free interconnection proposal is too narrow (because it excludes LEC transport and tandem switching), many of the same CMRS providers also argue that the proposal is too broad (because it includes traffic that, in their opinion, ought not be subject to "bill and keep").⁴⁹

For example, the CMRS industry takes the position that "bill and keep" is appropriate when traffic between a CMRS provider and a LEC is in balance. But the industry has an unusual definition of traffic balance. At least according to some CMRS providers, traffic is not balanced (and, therefore, "bill and keep" is not appropriate) when the ratio of

[N]o court has required a lawful monopolist to forfeit to a purchaser three times the increment of its price over that which would prevail in a competitive market. Berkey Photo v. Eastman Kodak, 603 F.2d 263, 294 (2d Cir. 1979)(internal citations omitted).

See also Williamsburg Wax Museum v. Historic Figures, 810 F.2d 243 (D.C. Cir. 1987).

⁴⁹ Compare, for example, PCIA Comments at 7-11 with id. at 11-12.

mobile-to-land:land-to-mobile (“M-L:L-M”) traffic is 0%:100%; however, these same providers claim that traffic is sufficiently balanced to warrant imposition of “bill and keep” when the ratio of M-L:L-M traffic is only 83%:17%.⁵⁰

The CMRS industry also takes the position that “bill and keep” is appropriate when the costs to terminate a call are small; but here, too, the industry has an unusual perspective about costs. Some CMRS providers allege that all of a LEC’s costs are so small that their interconnection with LECs should be free altogether — even though their calls may terminate over two or more LEC switches and even though a LEC may have to transport their CMRS calls 100 miles or more.⁵¹ On the other hand, many of these same CMRS providers assert that the cost of paging equipment — unlike a 60,000-line No. 5ESS end office switch or a No. 4ESS tandem switch — is “significant” and that application of “bill and keep” to their terminating traffic would be unfair.⁵² CMRS “costs for call termination are not zero,” they state.⁵³

⁵⁰ See Pacific Comments at v. See also Western Wireless Comments at 13 (ratio of M-L:L-M traffic is 80%: 20%).

⁵¹ In making its cost arguments, the CMRS industry relies exclusively on certain cost estimates prepared by their economist, Mr. Brock. U S WEST has demonstrated not only that these estimates are faulty, but that Mr. Brock’s conclusions are inconsistent with his sources. See U S WEST Comments at 32-37. See also U S WEST Attachment A, A Response to Dr. Gerald Brock by Professor Robert G. Harris, Walter A. Hass School of Business, University of California, Berkeley. USTA has documented that the costs LECs incur to provide CMRS interconnection are nearly \$440 million annually. Under no circumstances can it be said that costs of this magnitude are “nearly zero.”

⁵² PageNet Comments at 23.

⁵³ Arch Comments at 12 ¶ 20. See also PageNet Comments at 11-12.

These same CMRS providers also maintain a self-contradictory position about cost recovery. On the one hand, they assert that LECs should be required to offer them free interconnection — so they are treated better than other interconnectors. However, these same CMRS providers have an entirely different view of cost recovery in those circumstances where they say mutual compensation (rather than “bill and keep”) should apply. In those circumstances, these CMRS providers assert not only that they should be entitled to recover their common costs, but that they should also be allowed to use a LEC’s CMRS interconnection charges or its IXC access charges as a surrogate — even though they complain elsewhere that those charges are inflated because of subsidies. A surrogate is necessary, these CMRS providers say, because they don’t know their own costs.⁵⁴

The Commission has noted that CMRS providers enjoy “a highly profitable business” with the current interconnection charges they negotiated but now complain about.⁵⁵ In an attempt to increase their profitability even more, these providers do not simply ask that they also be allowed to recover their costs, but they want the Commission to permit them to charge LECs sums designed to subsidize local service — although they are under no obligation to provide any service below cost, no obligation to serve every customer upon demand, and no obligation to provide additional usage at no additional charge. At the same time, these same CMRS providers do not want LECs to continue to generate

⁵⁴ See, e.g., Arch Comments at 12 ¶ 20, PageNet Comments at 55 n.55.

⁵⁵ See First CMRS Report to Congress, 10 FCC Rcd at 8853 ¶ 28.

revenues that have been used to subsidize admittedly below-cost rates for local residential service.

This Commission's job is to promote the public interest, and the public interest is generally promoted by facilitating competition. But there is an important difference between the public purpose of facilitating competition generally, on the one hand, and favoring (or inhibiting) one group of competitors' private interests over those of another group. The free interconnection proposal, particularly when applied to an industry segment already imposing "a significant premium" in its retail rates and "earning economic rents of significant proportions,"⁵⁶ constitutes the latter rather than the former.

VII. Recommended Commission Actions

U S WEST recommends that the Commission take three steps: (a) terminate this proceeding so meaningful LEC-CMRS negotiations can move forward, incorporating the record into the new local interconnection proceeding that will be commenced shortly; (b) commence as quickly as possible a proceeding examining access reform and consider that subject in tandem with the Section 251 interconnection proceeding; and (c) examine the adverse effect below-cost local rates have on the access and local interconnection markets.

⁵⁶ *Id.* at 8869 ¶ 75 and 8871 ¶ 81.